SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 1155

ESTATE OF WILLIAM S. HULL, DECEASED, MESSRS. JONATHAN W. HULL AND WILLIAM HAROLD CARPENTER, SURVIVING EXECUTORS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

The Opinions of the Courts Below.

The opinion of the Board of Tax Appeals, a memorandum decision, dated August 12, 1940, is not reported, but it is set forth at length in the Record on pages 13-22.

The written opinion of the Circuit Court of Appeals for the Second Circuit is reported in 124 Fed. (2d) 503. (R. 104)

II.

Jurisdiction.

1. The jurisdiction of this court is invoked under section 240 (a) of the Judicial Code, as amended by the act of February 13, 1925.

2. The opinion of the Circuit Court of Appeals for the Second Circuit is dated the 7th day of January, 1942, and said court, on the 23rd day of January, 1942, duly issued its order and mandate to the Board of Tax Appeals affirming the latter's decision herein (R. 107).

III.

Statement of the Case.

A full statement of the case has been given under the heading in "A" in the petition, and in the interest of brevity no repetition of the statement will be made at this point.

IV.

Specification of Errors.

The reasons relied on for the allowance of the writ, appearing in the petition (*ante*, pages 7 to 10), contain the Specification of Errors now urged and are here adopted.

ARGUMENT.

Summary of the Argument.

POINT I.

The Record shows that the worthlessness of Primal Realty Corporation's stock became fixed in 1936 by the following identifiable events: (a) The issuance and service upon the corporation of notices of violations against its real properties under the New York Multiple Dwelling Law; (b) the completion of the assignment of rents, the consequent abandonment of its realty by the corporation and the recognition by the stockholders of the worthlessness of its stock; (c) the payment of tax arrears by decedent.

POINT II.

The finding of the Board of Tax Appeals that the rent assignment to the decedent was made in 1935 was erroneous

and against the weight of evidence and, therefore, the Circuit Court of Appeals was in error when it affirmed the Board's decision upon the ground that there was "substantial evidence" to support its findings.

POINT III.

A decision against the weight of evidence cannot be upheld upon the theory that there is substantial evidence to support it.

POINT I.

The record shows that the worthlessness of Primal Realty Corporation's stock became fixed in 1936 by the following identifiable events: (a) The issuance and service upon the corporation of notices of violations against its real properties under the New York Multiple Dwelling Law; (b) The completion of the assignment of rents, the consequent abandonment of its realty by the corporation and the recognition by the stockholders of the worthlessness of its stock; (c) The payment of tax arrears by decedent.

It is well established that to obtain an allowance of a deduction for a loss arising from an investment in stock the loss is deductible by the owner in the taxable year in which the stock became worthless, provided a satisfactory showing is made of its worthlessness.

Its worthlessness is always a question of fact to be determined in each case.

That Primal was insolvent in 1936 is conclusively established by an examination of its assets and liabilities in that year.

Its Assets.

Its only assets were the six pieces of real estate on Eighth Avenue and 115th Street (Pet. Ex. 4, R. 57). This exhibit consists of two balance sheets, one as of December

31, 1936, taken from the books of the corporation, and the other as of the same date taken from an appraisal of its real estate. Among its assets in each case is an item of $3506.97. In the balance sheet as per the books this item is denominated as "Cash held by Hull". In the balance sheet as per the appraisal this item is listed as "Cash". This cash was evidently held for the account of the decedent, as Mr. Dike, an officer of the corporation which handled the properties as agent, testified that "whatever money he, Mr. Hull, had in our hands was applied to the indebtedness on the houses that he had a mortgage on and was turned over to him and with his own money disbursed to clear up the taxes" (R. 45).

The item of $868.54 (asset) in the balance sheet as per the books is listed as "Due From Agent". In the balance sheet as per the appraisal this item is listed as "Due from Agents for Rents Collected". This item evidently related to rents collected by the collectors for the agents but not turned in. As will appear later, any such moneys belonged to the several mortgagees who had received assignments of the rents. However, it would make no material difference in the result as to the insolvency of the corporation, if these items were included as assets of the corporation, as its only other assets were its real properties. Its liabilities would still be far in excess of its assets.

The value of this real property is entered at its cost in the balance sheet as per the books, $141,500 after deducting reserve. In the other balance sheet the appraised value of the property is given as $77,000.

The fair market value of the real property was not in excess of $92,000.

Its Liabilities.

The face amount of all mortgages upon all the properties was $95,000. There were, however, arrears of interest and

of taxes on these properties. A statement with respect thereto appears in Petitioner's Exhibit 4 (R. 57) in which, as heretofore stated, two balance sheets are set forth, one based upon the cost of the real property and the other upon its value as appraised by the corporation. The liabilities, however, are identical in the two balance sheets. They show the face amount of the mortgages $95,000 and then interest payable of $1693 and taxes payable of $3,019.45; these two items evidently relate to the property held by the mortgagees, Church of the Incarnation and Audrey Woodward, as following these are other items due the decedent for advances to pay tax arrears $15,079.50 and interest thereon $829.37, and interest on his mortgages of $2860. The foregoing items of arrears of taxes and interest amount to $23,481.32. The result as to liabilities is as follows:

Principal due on mortgages	$95,000.00
Arrears of interest on mortgage and Arrears of taxes on the property	23,481.32
Total	$118,481.32

The foregoing evidence of assets and liabilities established the following result:

Value of real property, as per appraisal of Sasse, $92,000, liabilities $118,481.32, leaving a deficiency of $26,481.32.

Even if the finding of the Board as to the value of the real property was correct, viz., $99,000, the deficiency would still be $19,481.32.

In addition to the foregoing was the cost of compliance with the violations of the Multiple Dwelling Law, filed by the Tenement House Department in 1936, which the Board found to be about $12,000 for all of the houses. This would increase the above deficiencies to $38,481.32 or $31,481.32, as the case might be.

The insolvency of the corporation and the worthlessness of its stock became fixed in 1936 by the following identifiable events which occurred in that year: (a) The issuance and service upon the corporation of notices of violations against its real properties under the New York Multiple Dwelling Law; (b) The completion of the assignment of rents, the consequent abandonment of its realty by the corporation, and the recognition by the stockholders of the worthlessness of its stock; (c) The payment of tax arrears by decedent.

Violations.

These violations were issued and served under authority of the Multiple Dwelling Law, which is part of the Consolidated Laws of the State of New York, and known as Chapter 713 of the Laws of 1929. While this law was not put in evidence, reference was made to it, and it served as a basis for a finding (R. 16).

Notices of these violations were served on the corporation in July and August 1936 (Pet. Ex. 11, R. 60-77). Their removal required an expenditure of about $12,000 (R. 16). The corporation was without funds to make the alterations.

They were not merely notices with which the corporation might, at its option, comply. They were mandatory, and compliance therewith was essential to the further use of the property.

Failure to comply with the requirements of the notices subjected the owner to prosecution for misdemeanor and imposed upon it severe civil penalties (Multiple Dwelling Law, Sec. 304, Appendix herein).

Furthermore, failure to comply with the requirements of the notices rendered the corporation liable to damages to occupants of the premises for injuries suffered by reason of such failure.

In *Bernucci* v. *Marfre Holding Corp.*, 171 N. Y. Misc. Rep. 997, the owner was held liable for the death of plaintiff's intestate caused by defective fire protection in a lodging house from which he was trying to escape during a fire. Notice of the violations had been served on the owner, but he had not complied therewith. The Court said: "The statute was intended for the protection of the life and property of the occupants of the building and its breach created a liability *per se* in favor of those injured thereby" (R. 998).

See also: *Weiner* v. *Leroco Realty Corp.*, 279 N. Y. 127.

It is stated in the opinion of the Board that these notices were apparently nothing more than the formal effectuations of legislation passed some time before (R. 20). This is true. But without these notices the law was ineffective; it required these notices to make it effective. Until they were served the corporation could ignore the condition of the properties with impunity.

Apart from all technicalities, it is an undisputed fact that violations of the character enumerated in these notices had to be corrected by the owner and that the expense thereof made the property less valuable to the extent of the cost of such changes.

The expense of compliance with the requirements increased the rental value but little (R. 16).

The Circuit Court of Appeals in its opinion, at page 504, said: "Nevertheless the receipt of the notices did not alter the condition of the property. There was no intention to abandon it, and the corporation was still a going concern in 1936". (R. 106)

But these factors are immaterial when consideration is given to the significance of the violations.

Payment of Tax Arrears.

In 1936 decedent paid all the tax arrears on the properties taken over by him (R. 44). The Board made a specific

finding with regard thereto (R. 16). *But neither the Board nor the Circuit Court took cognizance of this important identifiable event.*

Abandonment of Its Properties.

While the corporation assigned the rents of the property upon which the Church of the Incarnation held a mortgage to the mortgagee in 1935, and, perhaps, also the rents of the property upon which Woodward held a mortgage (although this does not clearly appear), it retained control over the other properties upon which decedent held mortgages until 1936. While there was no formal written assignment of the rents from these four properties, yet there was an oral agreement with respect thereto. The Dike Corporation was agent for all of the properties. Up to 1936 it commingled the rents from all of them and paid the general expenses as might be necessary; but in 1936, by agreement between the holders of the stock of Primal and the mortgagees, the rentals from each property were kept separate and distinct and the taxes and other charges against each property were paid from its rentals. From that time on the corporation ceased to function with respect to the control of its properties. It had in effect abandoned the properties to the mortgagees. On demand of the mortgagees the rents were turned over to them, and they assumed the payment of taxes, retaining any overplus. The repairs necessitated by the notices of violations were made in subsequent years. They must have been made by the mortgagees for Primal was insolvent and had no cash or other assets with which it could have made the repairs.

In 1936, there was a conference between Mr. Dike, representing the Dike interest of one-third of the corporation, and the decedent, who represented another one-third interest (evidently Mr. Titchenor, the third stockholder, was

dead at this time) (R. 35). They discussed the condition of the corporation and both refused to put up any more money for the corporation. Decedent stated that he was only interested in the properties upon which he held mortgages and not in the other two properties.

With its treasury empty and the properties in the hands of the mortgagees, the corporation was helpless and it was absolutely impossible for it to carry on.

It was not necessary that the corporation should lose, or part with, the title to its real property by foreclosure or otherwise, or that it should be dissolved or judicially declared insolvent, to establish the loss in 1936. It was sufficient if, as a matter of fact, the corporation was insolvent.

The Board in its opinion said that no development in 1936 was shown to have been of such a decisive nature as to justify characterization as an "identifiable event" indicating that reasonable hope and expectation of value at some future time has been foreclosed "as might be the case on a showing of such events as bankruptcy, suspension of business, liquidation or receivership" (R. 22).

In so far as the Board intended to state that these enumerated events were necessary to be shown to establish worthlessness of the stock, it is not supported by the decisions of the courts, or of the Board itself.

In *Hancock* v. *Commissioner of Internal Revenue*, 105 F. (2d) 153, the Court held that the requirement that losses for income tax purposes, usually evidenced by closed and completed transactions, does not preclude deducting of loss in the year when the investment actually becomes worthless, though the owner has not parted with title to the property. The Court said:

> "While it is true, as the Treasury regulations have declared for many years, that 'losses must actually be evidenced by closed and completed transactions', this

> does not preclude the taking of a loss in the year when the investment actually becomes worthless, even though the taxpayer has not parted with his title (citing De-Loss *v.* Commissioner, 6 Cir. 100 Fed. (2nd) 966)" (R. 154).

It is the contention of the petitioner that all of the facts herein recited, showing the condition of the corporation, the assignments of rents, the refusal of the stockholders to put in more money, the fire retarding violations, and the payment of taxes in arrears, all constitute sufficient identifiable events to show the worthlessness of Primal stock in 1936, under the rule laid down in the above case.

To the same effect is the case of *Perkins* v. *Commissioner of Internal Revenue*, 41 B. T. A. 1225. At page 1230 the Board said:

> "The evidence seems to us to warrant the conclusion that two identifiable events sufficient to indicate the worthlessness of petitioner's capital investment took place in the taxable year 1936. The first was the loss of the corporation's tenant. The critical nature of this development was demonstrated by the subsequent filing of a voluntary petition in bankruptcy which might also be treated as an identifiable event. * * *
>
> Here, however, petitioner's claim of worthlessness being adequately supported by the independent event consisting of the loss of petitioner's principal asset, his contention that the stock was worthless prior to and separate from the bankruptcy is sufficient to eliminate the necessity of considering that point. * * *
>
> A loss predicated upon the worthlessness of stock may be allowed independent of the occurrence of any sale or exchange. We see no reason why it should not also be allowed independent of any liquidation."

In *Commissioner of Internal Revenue* v. *W. W. Hoffman*, 117 F. (2d) 987, the Board sustained a loss when the petitioners abandoned improved real property owned by

them, subject to a mortgage upon which they had not assumed liability. The loss claimed was for the year 1934. Violations pursuant to the Multiple Dwelling Law were filed against the property and the petitioners notified the mortgagee that they had abandoned their interest. The property was not foreclosed until after the year 1934. The Court affirmed the decision of the Board and said:

> "Upon amply sufficient evidence the Board found specifically that the taxpayers' interest in the property became worthless in 1934. We see no valid ground to differentiate between a loss suffered on real estate and one on personalty if worthlessness is definitely established. Compare Wieboldt *v.* Commissioner, 7 Cir. 113 Fed. 2, 384-6.
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> On the authority of Denman *v.* Brumback, 6 Cir. 58 Fed. 2 128-9 and Rhodes *v.* Commissioner, 6 Cir. 100 Fed. 2, 966, the Board's decision is affirmed."

The facts established by the record bring the present case fairly within the law laid down in the above cases and establish the worthlessness of Primal's stock in 1936.

The corporation had practically abandoned its real property by assigning all of the rents therefrom to the mortgagees; it was willing to convey the properties to the mortgagees; the fire retarding violations were served in that year; its loss in that year was $6255.70 (R. 58). Its assets were far below its liabilities; it had no cash or other assets with which to pay the arrears of interest or taxes or to comply with the violations; its stockholders refused to put up any money for its relief; and they considered its stock worthless, as evidenced by the holder of one-third of the stock offering to give it to decedent, who refused to accept it because he thought it was worthless.

As we have pointed out, there were arrears of interest on mortgages and of taxes in 1936 amounting to $23,481.32. In addition to these, were the moneys necessary to comply

with the municipal violations amounting to $12,000. The corporation could not regain possession of the properties which it had turned over to the mortgagees without paying their mortgages, the face value of which was $95,000. The corporation had no money and no assets whatsoever. There was no hope whatever that the corporation could raise the money necessary to discharge these obligations, and whatever hope any one may have had that it could do so was not founded on any degree of reason.

These facts established the worthlessness of the stock quite as conclusively as did the facts in any of the above cases.

In retrospect, in examining the operations of the corporation from the years 1933 to 1937, it may be seen that the corporation was practically insolvent in 1935. But the decedent did not have the benefit of retrospect. He had to speculate as to the future. This he could not foresee with accuracy. He had the right to indulge in hope and expectation that conditions would improve and that the value of the real property would increase so that the corporation might carry on and make yearly profits. Such had been the condition of the properties up to the year 1932. The profits had been sufficient to pay off a second mortgage upon them. The corporation was met by the general depression that began about 1932 and reached its lowest ebb around 1935 or 1936. Owners of real property which had weathered conditions down to 1935 had a universal hope and reasonable expectation that the bottom of the depression, with its effect on real property, had been reached, and that there would shortly be a turn and material improvement. Decedent had reason to indulge in this hope and expectation in 1935; that they would not materialize was not then within his definite knowledge or to be reasonably anticipated. It was not until the happening of the identifiable events of 1936 that this became obvious.

It is unfair to a taxpayer, where stock of a corporation which he owns at some period becomes definitely worthless, to compel the stockholder to speculate and determine in just what previous year it became worthless.

Point II.

The finding of the Board of Tax Appeals that the rent assignment to the decedent was made in 1935 was erroneous and against the weight of evidence, and, therefore, the Circuit Court of Appeals was in error when it affirmed the Board's decision upon the ground that there was "substantial evidence" to support its finding.

The Board of Tax Appeals relied principally upon its finding that the rent assignment to decedent was made in 1935 (R. 22). It predicated that finding upon the statement made by the witness Oscar Dike, referring to the latter part of 1935, that instead of issuing one statement from the managing agent, monthly statements were issued on each of the properties (R. 42). Without signifying any date the question was asked of Dike whether he meant that there was an assignment of rentals to the mortgagee and he replied that at first there was only a verbal agreement (R. 22, 43). *The witness gave clear testimony, however, that the assignment to the decedent was made in 1936.* He stated that in that year there was a change as to the manner of handling the account and that the mortgagees demanded that they should have control of their individual mortgage holdings (R. 36, 37). He also testified that when the violations were issued in the middle of 1936 the decedent had "just taken over the responsibility of the houses upon which he held mortgages" (R. 42). *This testimony was given immediately prior to the testimony relied upon by the Board of Tax Appeals to show that the assignment was made in 1935.* Then Mr. Dike testified that it was in the

year 1936 that decedent paid the tax arrears "when we turned everything over to him * * *" (R. 44).

It is submitted that it appears clearly from the entire body of the witness' testimony, rather than the isolated portion relied upon by the Board of Tax Appeals, that the rent assignment to decedent was made in 1936. The Circuit Court of Appeals so found. It is apparent that the principal finding made by the Board of Tax Appeals is without substantial evidence, and, therefore, the Circuit Court erred in its conclusion that the decision of the Board was supported by substantial evidence.

Point III.

A decision against the weight of evidence cannot be upheld upon the theory that there is substantial evidence to support it.

In 1936 the interest and tax arrears amounted to $23,481.32. The amount necessary to be expended to comply with the violations issued against the corporation's properties, under the New York Multiple Dwelling Law, amounted to $12,000. The rents of all of the corporation's properties had been assigned to the respective mortgagees. The corporation had no money and no assets whatsoever. It had no hope that it could raise the necessary money to discharge these obligations, and whatever hope anyone may have had was not founded on any degree of reason whatsoever.

The refusal of the stockholders to advance any more money to the corporation's treasury constituted a virtual abandonment of the properties.

The witness Oscar Dike (R. 45), testified: "He (referring to the decedent) wanted to know what I wanted to do and I said I can't do anything". After being asked a question whether the decedent was going to foreclose Mr. Dike gave the following answer: "We discussed it in an informal manner * * *."

The facts established by the within record bring the case at bar within the rule laid down in *Commissioner of Internal Revenue* v. *W. W. Hoffman*, 117 F. (2d) 987. It is to be noted that the Commissioner took no appeal from the decision of the Circuit Court of Appeals affirming the decision of the Board in the *Hoffman* case.

In that case the petitioners notified the mortgagee by letter that they had abandoned their interest in the property. This notice was given in the year 1934. In that case, as in the instant case, notices pursuant to the New York Multiple Dwelling Law had been filed against the property. The property was not foreclosed until the year 1935. The Board and the Circuit Court of Appeals both held that the loss occurred in the year 1934.

In the case at bar we have virtually the same situation except that title to the property involved is held in the name of a corporation and the loss claimed is for the worthlessness of the corporation's stock.

As appears by the record, the decedent and Mr. Dike discussed the situation in an informal manner. We see no basis to differentiate between a written notice given by the owner of mortgaged property to the mortgagee of their intention to abandon same and the informal discussion of the stockholders of a corporation deciding that they would put no more money into the treasury of the corporation when at the time such discussion was had all of the rents had been assigned to the respective mortgagees. An intention to abandon or a direct notice of abandonment does not become the more effective because it has been reduced to writing.

Treasury Regulations 94, promulgated under the Revenue Act of 1936, provide that in losses by individuals substance and not mere form will govern in determining the right of deduction. The facts in the case at bar should be viewed in the light of such rule.

The Circuit Court apparently affirmed the decision of the Board upon the ground that it could not say that the Board did not have substantial evidence to support its finding, and also that the decision, if further reviewed, was based upon findings supported by the record. *Helvering* v. *National Grocery Co.*, 304 U. S. 282, was cited.

In that case this Court granted certiorari because of the importance in the administration of the revenue laws of the matter there presented. This Court said at page 291:

> "There was *ample evidence* to support the finding of the Board of Tax Appeals."

In *Helvering* v. *Rankin*, 295 U. S. 123, the case was remanded to the Circuit Court for further consideration on the question whether a finding of the Board of Tax Appeals was without *substantial support* in the evidence.

There is nothing in the taxing statute or in the Regulations which requires that a decision of the Board of Tax Appeals *against the weight of evidence* should be sustained.

That a decision made by any court against the weight of evidence should be set aside or reversed in an appellate court is so firmly fixed in our jurisprudence that it requires no citation of authorities here.

It is to the interest of the proper administration of the Revenue Act that this Court review the facts in this record and pass upon the question whether the so-called substantial evidence is against the weight of evidence.

This Court stated in *Helvering* v. *National Grocery Co.* (*supra*) that the function of the Board is "to draw inferences, and weigh the evidence, and to declare the result". It did not say that the Board is vested with power to render a decision contrary to and against the weight of the evidence; nor is any such power found in the taxing statutes or in the Acts of Congress conferring jurisdiction upon the Board itself.

In order to obtain the necessary power to tax the income of citizens of the United States, it was necessary that a constitutional amendment be passed and this was done by the passage of Amendment No. 16 to the Constitution of the United States. Congress then proceeded to legislate under this amendment, declaring what shall be income and what shall be the deductions allowed taxpayers in computing and adjusting their net income. In the early days of income tax administration the Board of Tax Appeals was not in existence. It is a creature of the statute and is vested with such powers as are given to it by the statute. No express power has been given by Congress to the Board of Tax Appeals to render decisions not supported by the weight of the evidence in the case. To affirm the decision of the Board in the case at bar is to estop the taxpayer, arbitrarily, from deducting his loss, which right is given to him under the statute. Congress, by the creation of the Board of Tax Appeals, must have meant to institute an administrative board, wherein the parties are given an opportunity to petition for relief against a decision of the Commissioner. While the Board is purely of an administrative character, it could not have been contemplated by Congress that the Board be vested with power to render decisions contrary to and against the weight of evidence. The administrative function of the Board was not intended to be an appeal to the tax collector's conscience.

The taxpayer herein has proved his loss in accordance with the requirements of the statute and regulations. He should not be deprived of his property without due process of law—upon a determination of the Commissioner and the Board against the weight of evidence and by a Circuit Court affirmance, based upon the "substantial evidence" rule.

In Conclusion.

For the foregoing reasons it is respectfully submitted that the writ of certiorari should issue.

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